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No. 68

In the Supreme Court of the United States

OCTOBER TERM, 1939

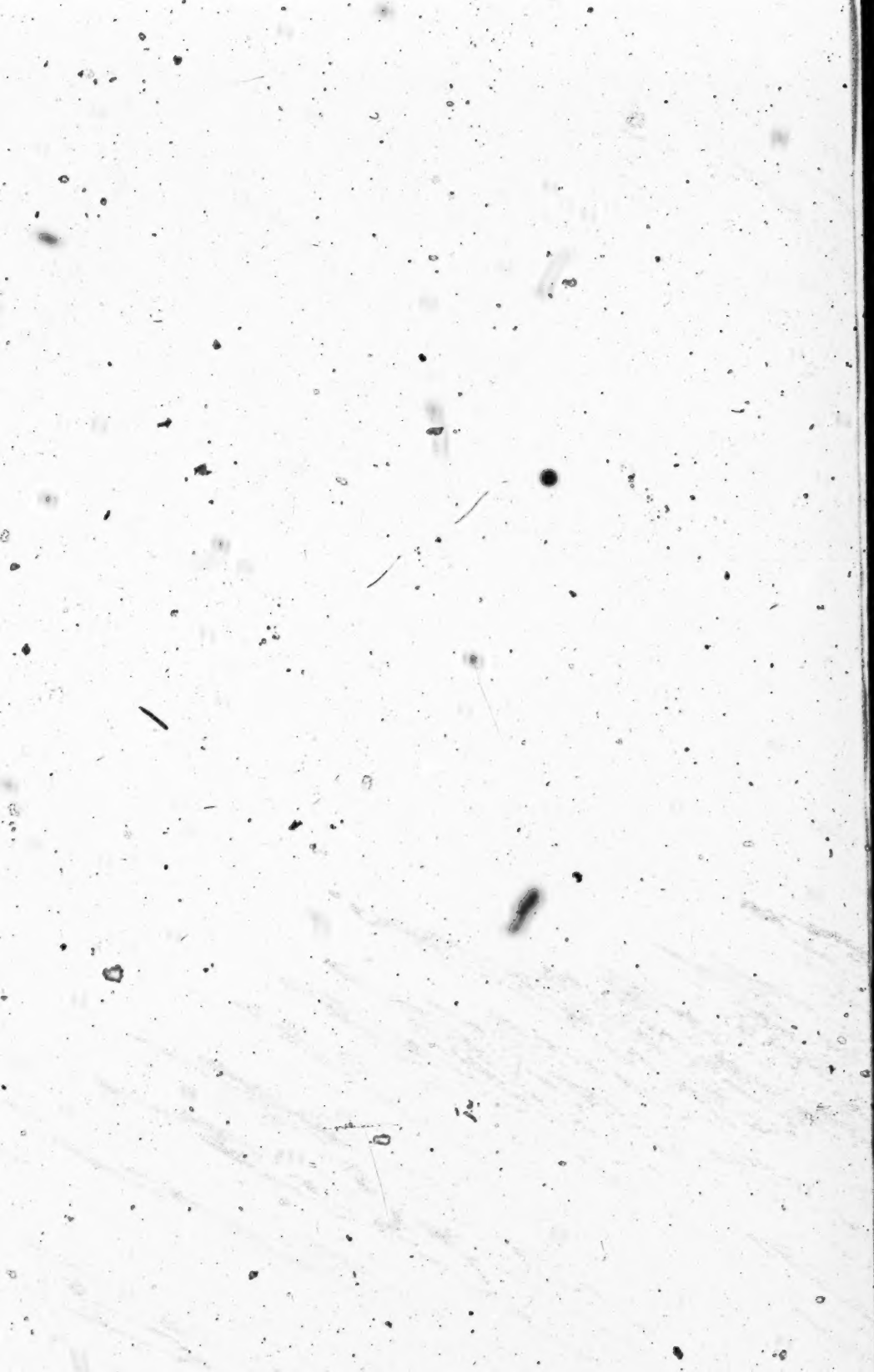
V. L. LETULLE, PETITIONER

v.

**FRANK SCOFIELD, UNITED STATES COLLECTOR OF IN-
TERNAL REVENUE FOR THE FIRST DISTRICT OF
TEXAS**

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION



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(1)

In the Supreme Court of the United States

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No. 63

V. L. LeTULLE, PETITIONER.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

No written opinion was filed by the trial court. The opinion of the Circuit Court of Appeals (R. 283-287) is reported in 103 F. (2d) 20.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 3, 1939 (R. 288). A petition for rehearing was filed April 21, 1939 (R. 289), and was denied April 27, 1939 (R. 293). Petition for a writ of certiorari was filed May 22, 1939. The

jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in the circumstances of this case, the exemption from taxation applicable to corporate reorganizations applies to a transfer of property which was owned, at the time of the agreement upon which the claimed reorganization was based, not by the transferor corporation, but by the taxpayer, its sole stockholder, and which was conveyed to the transferor corporation, if at all, only in order to be included in the properties conveyed to the transferee.

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(b) Exchanges solely in kind.—

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(d) *Same—Gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, * * *

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the dis-

tributee from the receipt of such stock or securities shall be recognized * * *

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term “reorganization” means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (E) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

STATEMENT

In 1931 the taxpayer was the sole stockholder of the Gulf Coast Irrigation Company (R. 65), which owned certain pumping plants, machinery, canals and other irrigation property (R. 76). The taxpayer individually owned certain other lands and irrigation properties (R. 287).

Pursuant to a contract dated November 4, 1931 (R. 75-90), the Gulf Coast Irrigation Company agreed to convey to the Gulf Coast Water Company all of the irrigation properties it then owned,

as well as "certain other lands and irrigation properties" which it "will be the owner of" prior to the time of conveyance (R. 76). The other lands and irrigation properties referred to in the contract were those then owned by the taxpayer individually. The transfer was to be made for a consideration of \$50,000 in cash and \$750,000 in secured bonds of the Water Company (R. 77).

The record discloses the method by which the taxpayer endeavored to include his individual property in the reorganization scheme.

On November 7, 1931, after the agreement with the Water Company had been executed, a special meeting of the stockholders of the Irrigation Company approved the proposed reorganization (R. 96). The minutes of this meeting state (R. 95) that the taxpayer, "desiring also to reorganize his interest in the properties", had consented to be a party to the reorganization. To this end, an increase of the capital stock of the Irrigation Company from 1,000 shares to 2,660 shares was authorized (R. 94).

The minutes of a special meeting of the board of directors of the Irrigation Company, held on the same day, indicate that the taxpayer had subscribed for the new stock and had agreed to pay the sum of \$166,000 "in property to be conveyed" to the company (R. 101). Thereafter, on November 18, 1931, the Irrigation Company (through the taxpayer as its president) and the taxpayer individually, joined

in a deed transferring the properties to the Water Company (R. 110-112). The record fails to disclose the transfer of the taxpayer's individual property to the Irrigation Company before the latter purported to transfer it to the Water Company.

Additional taxes for the fiscal period during which the transaction occurred were assessed against the petitioner as transferee and against the petitioner and his wife individually, on the ground that taxable gains resulted from the disposition of the property. The tax was paid and in due time suits were commenced to recover the amounts so paid, asserting that the transaction was a non-taxable corporate reorganization. The Government denied generally the allegations of the petitions. The cases were consolidated.

At the trial the taxpayer testified that he had made a prior contract for the sale of these irrigation properties to the Continental Service Company (R. 178). Thereafter, during the trial, the Government filed a motion for continuance (R. 41-57) for the purpose of developing the true situation. The motion alleged that the Government would be able to show that the taxpayer individually had already sold his properties before he agreed to transfer them to the Gulf Coast Irrigation Company for 1,660 shares of its stock, and that he should have accounted for the profit on the sale in his individual income tax return. The Government's motion further asserted that the contract of November 4, 1931, upon which the taxpayer was

relying to show a reorganization, was "a sham and a subterfuge to put into another form a completed transaction in order to avoid the tax that was due on such completed transaction" (R. 52).

The trial judge overruled the Government's motion for continuance (R. 58) and ordered judgment in favor of the taxpayer for the full amount (R. 59-61).

The Government again asserted that the property had been disposed of by the taxpayer before the purported reorganization, in its motion for a new trial (R. 205-213), which was denied by the trial judge (R. 266). At that time the Government had been able to get a copy of the original contract for the sale of the properties dated November 5, 1930, and executed by the taxpayer individually and as president of the Gulf Coast Irrigation Company (R. 217-224). Extracts of corporate minutes had also been obtained (R. 208-209) showing that the contract had been kept alive, that down payments had been made thereon and that the transferee of the rights thereunder was proceeding to close the deal. It was further asserted in the motion for new trial (R. 212) that evidence then available would show that there had been an outright sale of the assets in question before November 4, 1931, and that the contract dated November 4, 1931, "was entered into between the parties merely for the purpose of calling the transaction a reorganization for the sole and exclusive purpose of attempting to evade taxes."

In the assignment of errors (R. 270-276) exceptions were specifically taken to the refusal of the trial court to grant the Government's motion for continuance (R. 274) and its motion for a new trial (R. 275), and it was asserted that had an opportunity been given to prove the averments made in the motions it would have been demonstrated that the taxpayer had disposed of the property individually owned by him by an outright sale under the prior contract instead of through the purported reorganization.

The Circuit Court of Appeals did not regard the denial of the Government's motions as error but instead, on the basis of the facts established by the evidence in the record, reversed the judgment of the trial court insofar as it had applied the reorganization provisions to the properties individually owned by the taxpayer at the time the contract was entered into (R. 287).

ARGUMENT

1. We submit that the provisions of the statute precluding recognition of gain in corporate reorganizations do not apply to such transfers of the taxpayer's individual property as that shown by the evidence admitted in the record in this case, and that on that record the decision of the court below, reversing the judgment in part, is correct.

While the Government's primary defense had been that the bonds received from the acquiring corporation did not constitute a sufficient continu-

ing interest to sustain the application of the reorganization provisions to any part of the transaction, the fundamental issue before the court was whether the transaction was a reorganization within the meaning of the statute. The court below correctly held that the transfer of the taxpayer's individual property which was shown by the plaintiff's evidence was not a reorganization.

The petitioner, apparently seeking to overthrow the decision below on the ground that the Circuit Court of Appeals had no authority to apply to the facts any legal reasoning not urged upon the Court by the parties, relies primarily upon *General Utilities Co. v. Helvering*, 296 U. S. 200, as presenting a basis for certiorari. The cases are clearly different. In that case, the petitioner, a corporation, owned stock of another corporation which had enhanced in value. The petitioner declared a dividend which it paid in the stock of the other corporation at an agreed value per share, greater than the cost of the stock. The Government sought to tax the petitioner to the extent of such excess on the ground that it had declared a cash dividend and had disposed of the stock in liquidating the indebtedness thereby created. In asking the Circuit Court of Appeals to reverse, the Government's petition stated (p. 204):

The only question to be decided is whether the petitioner [taxpayer] realized taxable income in declaring a dividend and paying it in stock of another company at an agreed

value per share, which value was in excess of the cost of the stock.

The Court of Appeals answered that question in the negative but reversed upon the ground that the record as a whole disclosed a scheme on the part of the taxpayer to sell the stock and at the same time avoid the tax by going through the formality of declaring a dividend, distributing the stock in payment thereof and having the stockholders then deliver the stock to the purchaser. The Court of Appeals concluded that the stockholders were mere agents or conduits through whom the transfer of the stock was accomplished and that such a transaction should be disregarded as a sham. This ground was entirely new in the case and, as this Court pointed out (pp. 206-207) in reversing the Circuit Court of Appeals, involved an inference of fact directly in conflict with the stipulation of the parties and the findings.

Here, on the other hand, the record clearly shows that the property transferred included assets which at the time of the contract of sale were not the property of the corporation, which, as far as this record discloses, never were transferred to it, and which, if they ever became property of the Irrigation Company, did so for purposes wholly unrelated to that company's business.

The Government's defense in this case was based upon the general ground that the transactions in question involved a sale rather than a reorganization, and, although it was especially urged that the

bonds received from the Water Company did not constitute a sufficient continuing interest to establish a reorganization, the fundamental issue was whether the transaction brought the taxpayer within the exemption of the reorganization provisions. Although it rejected the theory upon which the Government sought to meet this issue, the Circuit Court of Appeals did not depart from the issue in deciding that as to the part of the assets which admittedly belonged to the taxpayer individually the transaction was a sale rather than a reorganization. The taxpayer had assumed the burden of showing that a reorganization occurred within the meaning of the statute. Under prior decisions of this Court, this required a showing of a genuine transfer of the old company's assets acquired and disposed of in the pursuit of its corporate purposes, as well as a continuing interest in the new company; the tracing of one company's genuine business assets into the other company in exchange for a substantial interest in the new company. Even though it be conceded that the taxpayer showed a sufficient continuity of interest through the acquisition of the secured bonds, nevertheless, as the Circuit Court of Appeals pointed out (R. 287):

The evidence [thus] plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his

company by the device above stated in order to transfer it to the purchaser along with the property of the Irrigation Company.

In *Helvering v. Gregory*, 69 F. (2d) 809 (C. C. A. 2d), affirmed, 293 U. S. 465, a similar situation was presented. There, the sole stockholder of an existing corporation desired to become owner of certain of the corporate assets. The assets were transferred to a new corporation, wholly owned by the taxpayer and created for the purpose of reducing taxes by receiving the assets and immediately issuing them to the taxpayer as a liquidating dividend. There, even more carefully than in this case, the forms of a reorganization were observed. There, too, the fundamental question was whether the transaction, formally correct, amounted to a reorganization within the meaning of the statute, and the Circuit Court of Appeals reversed upon a theory different from any advanced by the parties. The Government had contended that the new corporation should be disregarded and the transfers to and through it treated as inoperative. The Court of Appeals reversed on the ground that there was no reorganization, but upon a different theory, saying (p. 811):

We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to

the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a "reorganization," because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect.

This Court found no objection to the Circuit Court of Appeals exercising its judicial function by deciding the case on grounds different from those advanced by the parties, and affirmed the decision in an opinion which we believe is conclusive on the point involved here. *Gregory v. Helvering*, 293 U. S. 465. The concluding paragraph of that opinion is precisely applicable to the facts shown by the record in this case, if we disregard the lack of evidence here that title to the plaintiff's property was ever formally transferred to the Irrigation Company preparatory to the execution of that company's deed to the Water Company. The Court said (293 U. S. 470):

In these circumstances, the facts speak for themselves, and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of

subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

Although in the present case the trial court rejected the Government's offer to show that the original contract was with the taxpayer individually, that he was to acquire the property owned by the old corporation and to transfer it along with his own property in an outright sale, and that the later scheme was entered into solely to avoid taxes and bring the taxpayer's individual property within the scope of the reorganization statute, it is clear from the evidence introduced by the plaintiff himself that his own property was brought into the transaction as purported corporate property only for the purposes of this transaction, after the agreement was entered into, and not as a part of the Irrigation Company's business.¹

¹ Excluding from consideration the irrelevant controversy as to whether the motive for including the taxpayer's property in the transaction was tax avoidance or convenience in foreclosing on the bonds taken in exchange for the property, it is evident from the argument in the taxpayer's brief in support of the petition here that his property was not in-

The conclusion that only those portions of the assets which were corporate assets when the agreement was entered into were within the scope of the reorganization exemption was, we submit, clearly within the province of the court below, in determining the legal effect of the facts proved by the taxpayer; and the conclusion reached was clearly correct.

The Irrigation Company owned only a part of the property to be transferred. It agreed to acquire and transfer, in addition to its properties, certain other property then owned by the taxpayer (R. 76). After the agreement was completed the taxpayer, the sole stockholder of the Irrigation Company (Pet. p. 2), went through the formality of calling a special stockholders' meeting at which an increase in the capital stock of the corporation was authorized (R. 92-105). A few days later, a deed was executed by the corporation and by the taxpayer individually, transferring the properties so combined to the new corporation (R. 110-112). The record fails to show any transfer of the property from the taxpayer to the Irrigation Company. Here, as in *Helvering v. Bashford*, 302 U. S. 454, 458, even if a transfer of the taxpayer's property to the selling corporation were to be found in the record, any direct ownership by the selling corpora-

cluded in the transaction in furtherance of any corporate purpose of the Irrigation Company but merely to accomplish one or another of several possible personal advantages to the taxpayer as distributee of the proceeds of the transaction (Pet. pp. 17-22).

tion would be "transitory and without real substance," and part of a plan which contemplated the immediate transfer of the assets to the new company.

On the basis of such facts the court below was correct in excluding the taxpayer's property from the benefits of the reorganization exemption, *Gregory v. Helvering*, 293 U. S. 465; *S. A. MacQueen Co. v. Commissioner*, 67 F. (2d) 857 (C. C. A. 3d), and in remanding the case for the purpose of ascertaining the proper apportionment between the corporate and individual properties thus transferred.

The decision turns upon the peculiar facts of this case. The facts involved in the cases relied upon by the petitioner (Pet. 9-10) are so different that the decisions present no conflict and furnish no ground for the issuance of a writ of certiorari.

CONCLUSION

The case depends largely upon its own facts and was correctly decided below. There is no conflict. The petition should be denied.

Respectfully submitted.

GOLDEN W. BELL,

Acting Solicitor General.

JAMES W. MORRIS,

Assistant Attorney General.

SEWALL KEY,

JOSEPH M. JONES,

ROBERT K. MCCONNAUGHEY,

Special Assistants to the Attorney General.

JULY 1939.

